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CITY OF LIVERMORE
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

FOR THE YEAR ENDED
JUNE 30, 2008

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CITY OF LIVERMORE
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2008

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MEMORANDUM ON INTERNAL CONTROL

November 29, 2008

To the City Council of the
City of Livermore, California

In planning and performing our audit of the financial statements of the City of Livermore as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We noted no matters that we consider to be material weaknesses, however, we identified certain deficiencies in internal control that we consider to be significant deficiencies that are included on the Schedule of Significant Deficiencies.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The City's written responses included in this report have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates

CITY OF LIVERMORE

MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-01: Redevelopment Agency Transactions

Last year we identified the need for better coordination of Redevelopment staff with other departments to ensure transactions are accurately reported (See Comment #2007-01 and 2007-02 below). While we did not note errors with Redevelopment land transactions as was the case in the prior year, we did note other errors in the recording of advances made by the City to the Agency as follows:

- $988,000 owed by the Agency to the City was recorded as a loan receivable per City Council Resolution. The appropriate accounting transaction was to record this as an advance and not a loan.

- Interfund advances for Traffic Impact Fees were not reduced for a $188,000 payment the Agency made to the City. Although Agency records were posted accurately for the payment, City balances were not reduced.

General ledger balances should be subjected to added analysis and review to ensure ending balances are supported and appropriate. Receivables due from other funds, including those due from the Agency are required to be presented as interfund advances receivable, not loans receivable. Interfund balances should routinely be compared to reciprocal balances in the opposing fund to ensure they equal.

Management Response:

The Redevelopment Agency reporting structure has been changed from the Economic Development Department to the Community Development Department. The Agency staff, City Attorney staff, and Finance staff are now meeting weekly to review all Agency transactions.

It is understood that all loans between the Agency and City funds will be treated as advances. All general ledger accounts will be fully reviewed and supported at year end.

CITY OF LIVERMORE

MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF SIGNIFICANT DEFICIENCIES

2008-02: Purchasing Card Purchase Approval Procedures

During our review of purchasing card approval procedures, we noted that Department head cardholders are able to approve and reconcile their own purchases. Other employees' purchases are subject to review and approval. Purchasing cards are highly prone to misuse and should be subject to review and scrutiny to ensure transactions are for City business and conform to City policy. We understand the City performs a statement review process at the end each billing cycle; however, only a sample of employee transactions are selected during the month for review. Department head purchases may not be reviewed for several months. The City should revise the purchasing card approval procedures so that another employee reviews Department head transactions for compliance with policy guidelines.

Management Response:

The Finance Department and the City Manager's office are in discussions to update the Administrative Regulation regarding the use of purchasing cards.

CURRENT STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2007-01: Redevelopment Compliance & Contract Review

The Redevelopment Agency continues to be very active with a variety of complex development agreements and associated transactions impacting the Agency's financial statements. The transactions often cross department lines and require a high level of review and coordination to ensure they are recorded in accordance with generally accepted accounting principles. Whenever a new development agreement is created staff should meet to review and create a list of action items that are needed to accurately facilitate the administrative and financial aspects of the agreement. This coordination of efforts between department lines will lessen the chances of both compliance and accounting issues being overlooked.

Current Status: The Redevelopment Agency staff will make a concerted effort to meet with Finance and Housing staff and a representative from the City Attorney's office when negotiations begin for all development agreements. The attendees of these meeting will converse on the various administrative and financial aspects of the proposed RDA development agreement and assign tasks as necessary.

CITY OF LIVERMORE

MEMORANDUM ON INTERNAL CONTROL

CURRENT STATUS OF PRIOR YEAR SIGNIFICANT DEFICIENCIES

2007-02: Redevelopment Accounting

During our audit of the Agency, we noted staff recorded a land purchase for the Depot land parcel as of year end. Staff prepared and posted several entries to record the impacts of this purchase on land held for redevelopment, loans receivable and interfund advances.

However, these entries contained errors and required revision late in the closing and audit process. The primary reason for the revisions is that the transaction was accounted for in the current fiscal year, but the transaction took place in FY 08/09. Staff used estimated closing statements from the title company that reflected an incorrect closing date and this was not verified at the actual close of escrow. Further, some entries for this transaction were duplicated entries for loans receivable between funds. These errors were not detected when recorded nor during the close, but were reversed during the audit after review of the underlying documentation.

An increased emphasis is needed on redevelopment transactions. Of particular importance is an overview of redevelopment transactions and balances as transactions occur and are recorded. A careful comparison of those transactions to the originating documents will ensure they are properly recorded.

Current Status: The Redevelopment Agency staff will ensure that Finance staff receive a complete packet of documentation for all future land transactions. The packet should include a copy of all agreements, final sale and closing documents and escrow instructions. In conjunction with the recommendation above this step will be occurring earlier in the process.

CITY OF LIVERMORE

MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF OTHER MATTERS

2008-03: Information Technology Best Practices

We conducted an Information Systems Review with our audit which encompassed the financial information system and the network environment that houses it. We expanded our work in previous years beyond simply looking at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over the financial system. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever increasing sophistication of hackers and criminals.

Currently, there are no Information Technology standards which local governments are required to conform to. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. We understand the U.S. Department of Justice recommends these for local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

While the results of our work did not indicate material weaknesses or significant exploitable vulnerabilities, we did note a few areas which could be improved to conform to NIST guidelines. A summary of these recommendations which we believe are "best practices" are as follows:

- *Payment Card Industry Compliance* - Any organization that processes credit cards is required to comply with the Payment Card Industry Data Security Standard (PCI-DSS), even if the processing is outsourced. The standard was developed to minimize the risk of loss due to security breaches in processing credit card transactions. Merchants which conform to the Standard pay lower transaction fees and minimize their liabilities which may result from security breaches than those that do not comply. The Standard requires varying levels of controls depending on transaction levels. In general, merchants must:
    1. Fill out a self-assessment questionnaire (SAQ).
    2. Submit the SAQ to acquiring banks.
    3. Perform quarterly external network scans and submit the results to acquiring banks.
    4. Have a full independent PCI audit performed by a Qualified Security Assessor (QSA) and submit it to acquiring banks. (Required for level 1 merchants only).

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We believe the City qualifies as a Level 3 or 4 merchant due to activity levels of less than 1 million transactions and currently it need only complete and maintain the SAQ in-house. However, we understand SAQ submissions will become mandatory for Level 3 and 4 merchants in the near future. Staff have not completed the SAQ, but should do so and prepare for the submission requirement.

- *Audit/Event Logging* - We believe this is one of the more important standards of NIST. The City does not appear to have audit logs documenting any change, addition or deletion of user accounts within the financial information system. The City should have audit/event logs of any addition, deletion or change in financial information system user accounts and the logs should be monitored by someone without the rights to effect such changes to ensure only authorized appropriate changes are made. In addition, any administrative access such as upgrades or application modifications by Information Technology personnel, outside consultants or vendors should also be logged and reviewed.

- *General Information Systems Controls* - We compared the City's Information Systems controls with the various NIST standards and believe improvements should be considered for implementation such as employing Audit/Event logging, contingency planning and training and other areas. We have provided a detailed report to the City's Information Systems and Finance Staff which describes the control standards and the current status for their consideration.

  As noted above, the City is not required to conform to NIST standards and could use another set of guidelines to ensure the adequacy of controls. However, we recommend the City select an appropriate industry standard such as NIST to plan, organize and monitor information security proactively.

Management Response:

The City upgraded its financial reporting system in early 2009. We have provided the vendor with the requirements noted above and have been ensured that all of these will be met.

2008-04: <u>Documentation of Reviews</u>

As a result of enhanced procedures required under new audit standards, we noted certain reviews were lacking and should be improved especially in the area of documentation. We present them here:

Bank Reconciliation - Payroll Account Bank Reconciliation Review: During our testing of the December 2007 bank reconciliation for the payroll account, we noted that the reconciliation was not reviewed by another staff other than the preparer. It is important to have another staff review the reconciliation process to ensure the accuracy of the reconciliation.

Management Response:

This recommendation was implemented upon receipt of the comment from our auditors after the first part of their work. The Administrative Accounting Technician now gives the completed reconciliation to the Assistant Director of Finance who reviews, approves and initials the reconciliation.

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MEMORANDUM ON INTERNAL CONTROL

SCHEDULE OF OTHER MATTERS

Accounts Payable – Check Register and Check Log Review: When reviewing disbursement procedures we noted no documentation to indicate the check register report was reviewed after the checks had been run. We also noted Department heads review the total dollar amount after each check run; however, a specific employee not involved with processing accounts payable does not review the check run to ensure that individual checks are being processed for the correct payee and amount. In addition, there is no formal documentation to indicate the check log has been reviewed after each run. This process should be formally documented to ensure that it is being completed in a timely manner.

Management Response:

On a weekly basis the check register is reviewed for valid beginning and ending check numbers. Beginning check numbers are verified by comparing to the ending check number from the prior week. The check register in total is compared to the total A/P batch log. An approval stamp is used at the bottom of the check register and initialed by the Finance Manager to document the verification.

Accounts Receivable – Monthly billing review: We noted that governmental revenue invoices are prepared by various departments and Utility and Sewer invoices are generated by a utility software in which the retrieved data is uploaded from the Meter Reader's electronic device. The invoices are then reviewed by Finance Department on a monthly basis. However, we noted no employee documents that a review has been performed. The City should ensure the review is documented to indicate the review is done on a timely basis.

Management Response:

The Utility Billing Manager continues to document review by affixing a stamp to the bottom of each billing register indicating a review has been performed. The stamp will state "approved" and an initial and date will be written. The billing register will then be filed as normal.

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SCHEDULE OF OTHER MATTERS

2008-05: Upcoming GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets (Effective for fiscal 09/10) - Retroactive Application Required

Governments have different types of intangible assets, such as easements, water rights, patents, trademarks, and computer software. Easements are referred to in the GASB 34 description of capital assets, which has raised questions about whether and when intangible assets should be considered capital assets for financial reporting purposes.

The absence of specific authoritative guidance has resulted in inconsistencies in the recognition, initial measurement, and amortization of intangible assets among governments. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies and enhance comparability.

A summary of the statement:

- Intangible assets should be classified, accounted for and reported as capital assets, unless excluded from the scope. Guidance in this statement is in addition to existing capital asset guidance.
- GASB 51 specifically addresses the nature of intangible assets.
  - *Lack of physical substance.* An asset may be contained in or on an item with physical substance, for example, a compact disc in the case of computer software. An asset also may be closely associated with another item that has physical substance, for example, the underlying land in the case of a right-of-way easement. These modes of containment and associated items should not be considered when determining whether or not an asset lacks physical substance.
  - *Nonfinancial nature.* In the context of this Statement, an asset with a nonfinancial nature is one that is not in a monetary form similar to cash and investment securities, and it represents neither a claim or right to assets in a monetary form similar to receivables, nor a prepayment for goods or services.
  - *Initial useful life greater than one year.*
- GASB 51 excludes:
  - Assets acquired or created primarily for the purpose of directly obtaining income or profit.
  - Assets resulting from capital lease transactions reported by lessees.
  - Goodwill created through the combination of a government and another entity.
- Recognition of an intangible asset occurs only if it is considered identifiable. That is when either of the following apply:
  - The asset is separable from the government. That is it can be sold, transferred, licensed, rented, or exchanged.
  - The asset arises from contractual or other legal rights, regardless of whether transferable or separable.

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- Specific conditions must be present to recognize internally generated intangibles. Capitalization of costs begins after all of the following criteria are met:
  - Determination of specific objectives of the project and the nature of the service capacity expected upon the completion.
  - Demonstration of the feasibility that the completed project will provide its expected service capacity
  - Demonstration of the current intention, ability, and effort to complete or continue development of the intangible asset.
  - Internally generated computer software is used as an example in applying the specific conditions approach.
- Amortization lives are addressed:
  - Limited by contractual or legal provisions.
    - Renewal periods for rights may be considered if there is evidence that the government will seek and be able to achieve renewal and that any anticipated outlays to be incurred as part of achieving the renewal are nominal. Such evidence should consider the required consent of a third party and the satisfaction of any conditions required to achieve renewal.
  - An indefinite life (no amortization) is permitted so long as there are:
    - No limiting legal, contractual, regulatory, technological, or other factors, and
    - No subsequent change in circumstances.
    - A permanent right-of-way easement is an example.

Retroactive Application. For GASB 34 Phase I & II governments, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980. Retroactive reporting is not required for intangible assets with indefinite useful lives or internally generated intangibles, as of the effective date of this Statement.

***Management Response*:**

The City is in the process of reviewing possible areas in which this would apply and meeting with responsible parties in order to establish policy and procedures. The anticipates to meet the FY 09/10 implementation date.

CITY OF LIVERMORE

MEMORANDUM ON INTERNAL CONTROL

CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

2007–03: GASB Statement No. 48 - *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (effective for Fiscal Year 2007-2008)

This Statement establishes financial reporting of several categories of transactions. We have ordered the topics to those we believe are most relevant to cities and the other topics:

Issues Most Relevant to Cities:

- *Intra-Entity Transfers of Assets @ Carrying Value:* This Statement stipulates that governments should *not* revalue assets that are transferred between financial reporting entity components. Therefore, any assets (or future revenues) sold or donated within the same financial reporting entity should continue to be reported at their current carrying value when those assets or future revenues are transferred. Differences between the sales price and carrying value are recognized as a gain/ (loss) on the seller's statements and as an expense/ (revenue) on the buyer's statements. A transfer or subsidy treatment should be used in the basic financial statements.

- *Disclosures of Revenue Pledged for Repayment of Debt:* Though this GASB does not appear to impact the recording of debt with pledged revenues, it will expand disclosure requirements. We have italicized what we believe to be the *change* from current disclosures as follows:

  1. Identification of the specific revenue pledged and *the approximate amount of the pledge* [e.g. remaining debt service].
  2. Identification of, and general purpose for, the debt secured by the pledged revenue.
  3. The *term of the commitment* [e.g. remaining term of the debt].
  4. *The relationship of the pledged amount to the total for that specific revenue*, if estimable—that is, the proportion of the specific revenue stream that has been pledged.
  5. *A comparison of the pledged revenues recognized during the period to the principal and interest requirements for the debt directly or indirectly collateralized by those revenues.* For this disclosure, *pledged revenues recognized during the period may be presented net of specified operating expenses, based on the provisions of the pledge agreement*; [e.g. revenue coverage calculation] however, the amounts should not be netted in the financial statements.

- *Financing Authorities*: The Statement does not change the substance of accounting for revenues received by a government which are pledged for repayment of debt issued by a financing authority. The Statement requires the financing authority to recognize revenue when the pledging government is obligated to make the payments. This is essentially the counterparty perspective of recognizing debt service when due.

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CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

Other Topics:

- *Exchanges of Specific Receivables/Revenues for Cash*: Statement #48 states that "Governments sometimes exchange an interest in their expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments—generally, a single lump sum". The issue addressed is whether exchanges should be reported as a sale or as a collateralized borrowing resulting in a liability. A sale treatment is permitted only if the government relinquishes control of the exchanged receivable/revenue. Specific criteria are listed in the Statement which are used to determine whether control is retained (indicating a borrowing treatment) or relinquished (indicating a sales treatment).

  Exchange examples listed include the sale of future tobacco settlement revenues and the sale of delinquent property tax liens. These types of transactions are highly unusual and infrequent. This would have been helpful for those cities which securitized the VLF receivables.

- *Residual Interests and Recourse Provisions:* This Statement also includes guidance to be used for recognizing other assets and liabilities arising from a sale of specific receivables or future revenues, including residual interests and recourse provisions.

Current Status: implemented with the FY 2007-08 CAFR.

CITY OF LIVERMORE

MEMORANDUM ON INTERNAL CONTROL

CURRENT STATUS OF PRIOR YEAR OTHER MATTERS

2007–04: **GASB Statement No. 49 - *Accounting and Financial Reporting for Pollution Remediation Obligations* (Effective for Fiscal Year 2008-2009)**

This Statement addresses accounting and financial reporting for pollution remediation obligations (including contamination), which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement excludes pollution prevention and landfill closure or post-closure costs. A municipality must estimate expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
- A government has violated a pollution prevention-related permit or license.
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals but will be employed for the first time by governments. Statement 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

Pollution remediation outlays should be capitalized in the government-wide and proprietary fund statements when goods and services are acquired if acquired for any of the following circumstances:

a. To prepare property for sale. Capitalized costs (including pollution remediation costs) continue to be limited to lower of cost or net realizable value

b. To prepare property for use when the property was acquired with known or suspected pollution that was expected to be remediated. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.

c. To perform pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.

d. To acquire property, plant, and equipment that have a future alternative use. Outlays should be capitalized only to the extent of the estimated service utility that will exist after pollution remediation activities uses have ceased.

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For outlays under criteria a and b, capitalization is appropriate only if the outlays take place within a reasonable period prior to the expected sale or following acquisition of the property, respectively, or are delayed, but the delay is beyond the government's control.

Current Status: Staff will work closely with external auditors to prepare for the implementation of GASB 49. Required changes will be incorporated with the FY 2008-09 CAFR.

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CITY OF LIVERMORE

REQUIRED COMMUNICATIONS

November 29, 2008

To the City Council of the
City of Livermore, California

We have audited the financial statements of the City of Livermore as of and for the year ended June 30, 2008 and have issued our report thereon dated November 29, 2008. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

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Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008. As described in notes to the financial statements, during the year, the City implemented the following new standards:

- GASB Statement No. 45 – *Accounting And Financial Reporting By Employers For Postemployment Benefits Other Than Pensions*

  GASB 45 uses Pension Accounting (GASB 27) to change the accounting for Other Post Employment Benefits (OPEB) to full accrual at the Entity-wide and proprietary funds financial statement levels. Under the concepts in GASB 45 an actuarial study or simplified measurement method calculation is performed to determine an Annual Required Contribution (ARC). So long as employers contribute this amount every year, no accrual adjustment is needed in the financial statements. A summary of the impacts of this statement are presented below.

  As discussed in Note 10 to the financial statements, during the year ended June 30, 2008, the City made contributions toward the ARC for fiscal 2007-08 by paying retiree health care premiums and paying additional contributions to into a separate irrevocable trust established for the sole purpose of funding OPEB. This Trust is governed by a separate board, which is not appointed or controlled by the City Council or management and it has therefore been excluded from the City's financial statements. This Net OPEB Obligation has been recorded as an obligation and is being amortized over the actuarial amortization period. There was no cumulative effect of the accounting change as of the beginning of the year.

- GASB Statement No. 48 – *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*

  This Statement establishes financial reporting of several categories of transactions. There was no cumulative effect on prior year financial statements. However, Note 7 to the financial statements was modified to include disclosures of revenue pledged for repayment of debt.

- GASB Statement No. 50 – *Pension Disclosures — an amendment of GASB Statements No. 25 and No. 27*

  This Statement amends current disclosures for cost sharing defined benefit pension plans by requiring among other things, funding trend data for cost sharing pools. Note 10 to the financial statements was modified and enhanced primarily by the inclusion of trend funding tables for the State-wide pool the City participates in.

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008. While there have been no changes in accounting policies or disclosures resulting from the credit crisis, we believe the unprecedented volatility of credit markets occurring after year end warrants mention.

CITY OF LIVERMORE

REQUIRED COMMUNICATIONS

Credit Risk and the Financial Crisis: The City has credit risks in three primary areas of its operations: investments (Note 3), loans receivable (Note 5), and variable rate debt (Note 7). Credit risks as of June 30, 2008 for these areas have been disclosed in accordance with generally accepted accounting principals.

However, subsequent to year end, financial markets experienced significant reductions of available credit and certain financial institutions have had their credit ratings downgraded with one large institution entering bankruptcy. The federal government has taken steps to support financial markets in an effort to stave off further negative trends. These conditions have increased credit risks which warrant continuous monitoring and reassessment of the risk that credit counterparties and investees maybe downgraded or be unable to fulfill their obligations. The City should place the highest priority on maintaining a credit watch on its counterparties and formulate contingency plans as needed to ensure credit shortages do not significantly affect its operations.

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are discussed below:

- *Estimated Fair Value of Investments (*Note 3 to the financial statements*)* - As of June 30, 2008, the City held approximately $197 million of cash and investments as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2008. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2008.

- *Claims Loss Reserves (*Note 13 to the financial statements*)*– The City is exposed to a variety of risks of loss due to general liability and workers compensation claims and records an estimate of these losses based on an actuarial study performed by a third party consultant actuary. This study is prepared based on the City's prior claims history which is used as a basis for extrapolating losses for known and incurred but not reported claims. Actual loss experience will vary form estimates.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

Difficulties: We encountered no serious difficulties in dealing with management relating to the performance of the audit.

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REQUIRED COMMUNICATIONS

Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us but not recorded by the City that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process.

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the Council.

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This report is intended solely for the information and use of the City Council, its committees, and management and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates